Diese Website verwendet Cookies von Google, um Dienste anzubieten und den Traffic zu analysieren. Deine IP-Adresse und dein User-Agent werden zusammen mit Messwerten zur Leistung und Sicherheit für Google freigegeben. So können Nutzungsstatistiken generiert, Missbrauchsfälle erkannt und behoben und die Qualität des Dienstes gewährleistet werden.

WEITERE INFORMATIONEN OK

An unending variety of topics

Thursday, May 29, 2008

The Coase Theorem is false: contracts depend on tort law

In the Rothbardian ideology of anarcho-capitalism, all law can supposedly be derived from contract, the entry into which is supposed to be voluntary. "Social contract" theories of government also tend, by this euphemism, to suggest that the formation of governments was somehow voluntary, an idiotic idea that anarchists such as the legal scholar Lysander Spooner have easily debunked.

David Friedman justifies his neoclassical version of anarcho-capitalism by the Coase Theorem, which translated into legal terms is usually understood as the following: in the absence of transaction costs, and regardless of the prior allocation of legal rights, any tort ("externality" in economic terms) can be resolved by voluntary bargaining to form a contract, resulting in an economically efficient outcome.

Here are some places where Friedman relies on the Coase Theorem:

> Consider two [legal protection] firms with somewhat different customer bases, bargaining over what court's legal system to agree on. Firm A prefers one legal system, say one that permits capital punishment for murder. Firm B prefers a different system, one that does not permit it.
>
> Each firm estimates the value to its customers, and from that the increase it can expect in its revenues, if it can provide them with its preferred legal system. We expect, along conventional Coaseian lines, that they will agree on the system that maximizes their combined benefit. [Source].
>
> A still more attractive and more likely solution [to avoid war] is advance contracting between the agencies. Under this scenario, any two agencies that faced a significant probability of such clashes would agree on an arbitration agency to settle them-a private court. Implicit or explicit in their agreement would be the legal rules under which such disputes were to be settled. Under these circumstances, both law enforcement and law are private goods produced on a private market...
>
> Readers familiar with the economic literature on efficiency may notice that my argument owes more to Coase than to Marshall. I have relied on the idea that parties will negotiate towards efficient contracts, rather than on the conventional analysis of a competitive industry....[Source]

Pages

- Home

About Me

Nick Szabo

"A premier thinker about history, law and economics, and the lessons they have for security." -- Adam Shostack, Emergent Chaos

"Szabo comes out with these essays that leave me in awe." -- Brian Dunbar

"Reading material that is eclectic, challenging and endlessly fascinating." -- Sean McGrath, Propylon

"Like most blogs worth my attention, this blog is updated only infrequently. That is because the authors of blogs worth my attention only post when they have something to say that is true, relevant and not already known by their audience. Most of the human race does not have the skill to know when an idea has these three properties. The skill is particularly rare in the fields of politics and economics, which is why this blog is such a rare and valuable thing." -- Richard Hollerith

View my complete profile

The proof that the Coase Theorem is false is actually quite simple: the assumptions of the Theorem contradict each other. The assumption that transactions are voluntary contradicts the assumption that *any* prior allocation of rights is possible, including rights that allow one party to coerce another. In fact, for the Theorem to at all make sense, a very large and crucial set of prior rights allocations must be excluded -- namely any that allow any party to coerce another.

But we can't generally solve externalities problems by bargaining under this revised assumption. Externalities cannot be neatly distinguished from coercive acts, as extending one of Coase's own examples illustrates. In this example we have a railroad with a train that, passing by a farmer's wheat field, gives off sparks, which may start a fire in the field. In Coase's account, the prior allocation of rights might give the railroad the right to give off sparks, in which case the farmer must either plant his wheat far enough away from the railroad (wasting land) or buy the right to be free from sparks from the railroad. The prior allocation might instead already give the farmer the right to be completely free from sparks, in which case the railroad can either buy the right to emit sparks from the farmer or install spark-suppressors. If these are the two possible prior allocations of rights, Coase concluded that the railroad and the farmer will in the absence of transaction costs bargain to the most economically efficient outcome: if it costs less for the railroad to reduce the sparks than for the farmer to keep an unplanted firebreak, bargaining will achieve this outcome, and if the reverse, bargaining will achieve the reverse outcome, regardless of whether the farmer initially had the right to be free from sparks. So far, so good -- it seems, on the surface, that if bargaining is costless an efficient outcome will be achieved.

The problem is that these are not the only prior allocations possible. The Coase Theorem is supposed to work under *any* other allocation of prior rights. But it doesn't. It fails for a large and crucially important class of prior allocations: namely any that allow one party to coerce another. Here's an allocation that may or may not allow coercion, depending on your definition of coercion: a prior allocation that gives the railroad the right to emit as many sparks as it wants. In particular it includes the right of the railroad to emit sparks even if it could costlessly avoid emitting them. Here's one that is fairly clearly coercive: the right to emit sparks even if emitting them costs the railroad something extra (i.e. giving the railroad the right to purposefully emit sparks to start fires even at some extra cost to the railroad). Here's another farther down the coercive spectrum: a prior allocation that gives the railroad the right to torch the farmer's entire field with a flamethrower.

It is usually the case with coercion, as here, that it is far cheaper for the coercer to cause harm than for the victim to prevent it. To increase the threatened harm to the farmer, and thus the revenue it can obtain from extortive bargaining with the farmer, the railroad can spend extra to purposefully threaten the farmer. Here, it is likely far cheaper for the railroad to install a super spark emitter, or a flamethrower, than for the farmer to defend his fields from these sources. Indeed, since any prior allocation is possible, why stop with the farmer's fields? Another possible allocation would give the railroad a right to torch the farmer's barns, and his house, to kidnap his children -- any prior (*ex ante*) set of rules is supposed to be possible. In turn, if the *ex ante* rules allow, the farmer could threaten to tear up the railroad tracks or sabotage them to derail the trains. Under all these prior allocations of rights that allow coercion, the railroad need not just bargain to avoid the costs of supressing its externality (whether sparks or flamethrowers), nor need the farmer bargain just within this artificially voluntary spectrum of possibilities that Coase and his followers assume. Instead, if the *ex ante* rules so allow the railroad and farmer will bargain to avoid a negative-sum outcome: harm to the farmer with no direct benefit to the railroad, or vice versa. Since there are substantial *ex post* benefits to one party from extorting payments from the other, the party that can threaten the most harm at the least cost to itself has, if the *ex ante* rules allow, a strong economic incentive to engage in such coercion. These negative-sum games of coercion and extortion lead to highly inefficient outcomes, and they can only be avoided by carefully crafting the *ex ante* rules to avoid such coercion and extortion. These coercive threats that make negative-sum games possible, and that decrease the payoffs of positive-sum games, cannot be neatly distinguished in practice from innocent externalities: any act or omission of one party that harms another, i.e. any externality, doubles as a threat, whether a tiny threat or a large threat, from which an extortion premium, its size depending on the size of the threat, can be extracted.

In order to try to distinguish coercion, and the extortion it gives rise to, from an "innocent" externality that can be cured by efficient bargaining, there are ways to exclude some of these extreme possibilities from the prior allocation of rights. And indeed criminal and tort law do this: they distinguish purposeful behavior from negligent, and negligent from the mere unfortunate accident. But any such

Blog Archive

- ► 2018 (1)
- ► 2017 (3)
- ► 2016 (4)
- ► 2015 (3)
- ► 2014 (3)
- ► 2013 (3)
- ► 2012 (8)
- ► 2011 (12)
- ► 2010 (9)
- ► 2009 (29)
- ▼ 2008 (55)
  - ► December (2)
  - ► October (2)
  - ► September (4)
  - ► August (9)
  - ► July (4)
  - ► June (6)
  - ▼ May (6)
    - The Coase Theorem is false: contracts depend on to...
    - Off-the-shelf seasteading
    - Unenumerated sells out
    - Political bubbles
    - Ben Bernanke plays John Law
    - Daydreams in passing
  - ► April (4)
  - ► March (10)
  - ► February (5)
  - ► January (3)
- ► 2007 (47)
- ► 2006 (130)
- ► 2005 (44)

ex ante distiction contradicts the claim that the Coase Theorem applies to *any* prior allocation of rights. Voluntary bargaining cannnot give rise to tort and criminal law. Quite the opposite is true: at least a basic tort law is necessary to make voluntary bargaining possible. Tort law (and the associated property law which defines boundaries for the tort of trespass) is logically prior to contract law: good contracts depend on good tort and property law. Without a good tort law already in place, nobody, including the "protection firms" posited by anarcho-capitalism, can engage in the voluntary bargains that are necessary for efficient outcomes.

This is not to claim that the polar opposite of anarcho-capitalism must be true, i.e. that "the government" along the lines we are familiar with is necessary. Instead, a system of political property rights that is unbundled and decentralized is possible, and may give rise to many of the benefits (e.g. peaceful competition between jurisdictions) promised by anarcho-capitalism. But political property rights are not based on a Rothbardian assumption of voluntary agreement -- instead, in these systems the procedural law of political property rights, as well as much of substantive property rights and tort law, is prior to contract law, and their origin necessarily involves some degree of coercion. Political and legal systems have not, do not, and cannot originate solely from voluntary contract. Both traditional "social contract" justifications of the state and the Rothbardian idea that contracts can substitute for the state are false: in all cases coercion is involved, both at the origin and in the ongoing practice of legal procedure. In both cases the term "contract" is used, implying voluntary agreement, when the term "treaty", a kind of agreement often forced by coercion, would far more accurately describe the reality. The real task for libertarians and other defenders of sound economics and law is not to try to devise law from purely voluntary origins, an impossible task, but to make sure the *ex ante* laws make voluntary bargaining possible and discourage coercion and extortion (by any party, including political property rights holders or governments) as much as possible.

Posted by Nick Szabo at 5:27 PM

37 comments:

Michael said...

"The proof that the Coase Theorem is false is actually quite simple: the assumptions of the Theorem contradict each other. The assumption that transactions are voluntary contradicts the assumption that any prior allocation of rights is possible, including rights that allow one party to coerce another. In fact, for the Theorem to at all make sense, a very large and crucial set of prior rights allocations must be excluded -- namely any that allow any party to coerce another."

Your proof is incomplete -- it only holds for the scenarios in which the prior allocation of rights permits coercion.

Coase was not unaware of these problems with his theorem. The big fish he had to fry was with the Keynsians who believed that more law and regulation was necessary to promote markets. The Coase Theorem is still quite valid and useful for its suggestion that transactions costs -- which laws and regulations can either increase or decrease -- are what blocks efficient reallocations of resources.

Also, the way you're referring to "externalities" here is not consistent with my own understanding of the concept (although I will admit that it is used casually to mean what you here seem to mean).

Properly understood, "externalities" do not include the costs and benefits to the parties directly involved with a contract or tort. In other words, an "externality" (whether positive or negative) is the cost or benefit to non-parties of the contract or tort in question.

7:03 AM

George Weinberg said...

The Coase Theorem never seemed to be of much practical significance, since transaction costs are never zero and it's not true that all efficient outcomes are equally good. Your objection points out another practical flaw: however rights are determined, there won't be universal agreement as to who has what rights, nor will enforcement of rights ever be perfect or costless.

The practical point would seem to be that if rights are cheaply transferable it's much more important that questions of right, once decided upon, are considered permanently settled than what the particular decisions are. But even that is only true within the limits of what is likely to be accepted as reasonable.

1:27 PM

nick said...

Michael: *Your proof...only holds for the scenarios in which the prior allocation of rights permits coercion.*

Of course, but as I observed, externalities are not readily separable from coercion. Externalities problems always come bundled with at least a small threat of coercion. (BTW the term externalities does apply *ex ante* -- the externalities problem already exists, either in actual act or in threat or both, and Coase is trying to solve the externality problem by contract). The assumption is even worse for anarcho-capitalists, who can't take for granted any sort of ambient property and tort law that magically causes coercion to vanish, as Coase seems to have done. The fact of the matter is that the assumptions of the Coase Theorem as it is commonly used, especially by anarcho-capitalists, contradict each other. Coase may have nominally or casually "recognized" this problem, but neither Coase nor any other users of this Theorem as far as I am aware have seriously addressed this problem or tried to resolve it. (Although I have been told that Friedman tried to tackle this problem in *Law's Order* -- I haven't read it -- if somebody would care to put forward any such argument I'd be happy to address it). Instead invokers of the Coase Theorem happily go on deducing their conclusions from a false theorem, usually in a context where coercion can be an important problem.

Coase himself, after (as with George) observing the importance and ubiquity of transaction costs, did come to what I consider the proper theoretical conclusion, that the prior allocation should give the legal duty to the lower cost avoider of the externality. (i.e. the legal right goes to the party who would have the higher cost to prevent the harm). By lucky accident this also seems to solve the coercion problem, but Coase arrived at this good answer by bad reasoning. And neoclassical anarcho-capitalists depend on the false Theorem, not Coase's conclusion based on the ubiquity of transaction costs, for their argument that a legal system can be constructed from contracts.

George: *The practical point would seem to be that if rights are cheaply transferable it's much more important that questions of right, once decided upon, are considered permanently settled than what the particular decisions are.*

Since this is a deduction from the Theorem, and the Theorem is false, I seriously question this conclusion, especially in the context of anarcho-capitalism and more generally the degree to which political systems can be established and maintained on a voluntary basis.

While I quite agree that the permanancy of legal rights is very important, I also believe that even in the absence of transaction costs, when negotiating a contract the *ex ante* legal rights matter, and deeply so, to economically efficient outcomes, because of the problem of coercion. Transaction costs and the problem of coercion are both important reasons that there is no "market" in legal procedure, nor any "market" in externalities unless in the case of the latter a sophisticated property and tort or criminal law already exists. To take another Coaseian example, private trade in radio spectrum requires criminal or tort laws that punish at least jamming, and often also lesser but known forms of interference as well, as well as monitoring (either private or public) to detect such trespass. Mere contracts negotiated against the backdrop of law (or lack thereof) that allows parties to jam each other will probably lead to very poor outcomes.

11:29 AM

Clayton said...

"The assumption that transactions are voluntary contradicts the assumption that any prior allocation of rights is possible, including

rights that allow one party to coerce another."

Every transaction is "coercive" by your definition. Is the seller coercing the buyer to give him $1.15 for the soda the buyer wants to purchase or is the buyer is coercing the seller to give away the soda he's selling for $1.15?

As for the difference between sparks and arson, it is not so difficult to discriminate between the two (in some cases, adjudication may be required to differentiate). In the case of sparks, we may arbitrarily assign the right to spark or not to spark and as long as that right can be bought and sold, we expect an efficient allocation of resources to result.

In the case of arson, we set the fine to the average cost of arson divided by the probability that an arsonist will get caught (on average, this should be zero-sum). If the arsonist derives more benefit from his arson than the fine, he will burn the field. Otherwise, he will not burn the field. The fact that someone could burn my field (and, perhaps, use the threat of burning my field to coerce me) does not mitigate against Coase's theorem for the simple reason we are talking about two separate, distinguishable problems. If the railroad is granted the right to throw sparks, of course the railroad is going to "coerce" the farmer to pay them to stop throwing sparks in the same sense that the seller of a soda "coerces" the buyer to pay him $1.15 or the buyer of a soda "coerces" the seller to give away the soda for $1.15.

Where Coase's theorem does run into trouble is the public goods problem. How do you solve the problem of 5 different railroad companies using one track that runs along 100 farms? There is no obvious way to assign the rights to throw sparks or to not have sparks thrown. If we assign the 5 railroads the right to throw sparks, how do the farmers get around the holdout problem (one railroad company holding out for a higher price)? Vice-versa, how do the railroads avoid the problem of a holdout farmer if the right to not have sparks thrown is given to the farmers? The answer may be that government, as inefficient as it is, has heretofore been the most efficient solution to these kinds of problems, and (on an evolutionary view) that may be why governments exist. But many problems to which government has been the most efficient solution in the past (e.g. postal services) can now be solved much more efficiently through other means. The preconditions for this to be the case with tort law may fall into place in the future, as well.

9:54 PM

Ryan said...

I think Clayton really missed the point of the argument. Coase assumes neither party is engaging in coercion. The railroad owner goes to the wheat farmer and says "we can throw sparks 100 yards from our rails at almost no cost, and if you want to plant wheat anywhere near our rails then you have to give half of it to us." There is no negotiation, the farmer can either not plant wheat on their land or give half the harvest to the railroad as a protection payment. The farmer has no bargaining power. So the anarcho-capitalists who want to extrapolate coase into a justification for a contract-only are making a big logical mistake, they're huge critics of government as a protection racket but they have to simply ignore them to make a model for a world without governments.

11:02 PM

Clayton said...

Coase assumes neither party is engaging in coercion.

I wasn't saying otherwise. My point is that setting the price at which one is willing to buy or sell a private good (the right to throw or not to throw sparks) cannot be called "coercive" without making everything coercive.

The railroad owner goes to the wheat farmer and says "we can throw sparks 100 yards from our rails at almost no cost, and if you want to plant wheat anywhere near our rails then you have to give half of it to us." There is no negotiation, the farmer can either not plant wheat on their land or give half the harvest to the railroad as a protection payment. The farmer has no bargaining power.

Sure, he has if he has money. If he doesn't have money, it could be because what he is doing isn't very profitable and his energy would be better spent elsewhere rather than obstructing the (profitable) business of train transportation.

Or vice-versa if the train company can't scare up the money to pay the farmer for the right to throw sparks (if the farmer holds that right). Perhaps the train company would be better off doing something else other than obstructing the farming in order to do its business which is not profitable enough to pay the farmer for the right to throw sparks or install spark arrestors.

Who can solve the problem more cheaply is beside the point for the initial distribution of rights. The right will be bartered (assuming low enough transaction costs) until the globally most efficient resolution of the conflict is found.

The point of Coase's theorem is that it isn't externalities that are the problem, since externalities are both positive (Edison's invention of the lightbulb is a positive externality from which we have all been benefitting free of charge for over a century) and negative (the usual suspects... pollution, eyesores, insurance risks, etc.) The problem is [i]transaction costs[/i]. Where transaction costs are high, we expect to see a less efficient distribution of rights and resources than where transaction costs are low.

So the anarcho-capitalists who want to extrapolate coase into a justification for a contract-only are making a big logical mistake,

I don't know anything about Rothbard's ideas or "contract only" society. What little of his stuff I have read sounds quite utopian to me. What I do know is that there is no reason to believe that government intervention reduces negative externalities by a greater degree than it increases them (taxes are an obvious negative externality, as are stifling regulations and misguided public works investments) or increases positive externalities by more than it reduces them.

they're huge critics of government as a protection racket

Government is indistinguishable from a protection racket, except for the badges, seals and snappy uniforms.

but they have to simply ignore them to make a model for a world without governments.

As I like to say, "we need governance, but we don't need governments." That is to say, we need the *services* which governments provide, but there is no reason to believe that many (if not all) services provided by government cannot be provided more efficiently in a competitive market.

And in fact, this is already occurring. US municipalities are being forced to make corporation-like decisions about whether to handle things internally, or contract them out (the much maligned spectre of "privatization") in order to remain competitive with other US cities in attracting human and capital resources. This is a function of the free immigration within national borders. As people become more globally mobile, I hope to see this trend extend to national governments. I think that inter-governmental competition is the only force powerful enough to limit the extremely top-heavy governments of modern Western nations.

1:44 AM

Clayton said...

I have to comment some more...

it is far cheaper for the coercer to cause harm than for the victim to prevent it. To increase the threatened harm to the farmer, and thus the revenue it can obtain from extortive bargaining with the farmer, the railroad can spend extra to purposefully threaten the farmer.

Yes, but let's consider region A where extortive bargaining is common and region B where mutually beneficial bargaining (voluntary transactions) is common. Over time, we expect region B to operate much more efficiently than region A. Without national boundaries to protect it from encroachment of investment from businesses from region B, region A will eventually be overrun by region B.

I would argue that this is very much like the international scene today. Western nations largely respect private property rights (everyone except the government itself does), where third world countries universally engage in bribery, extortion and other coercive transactions. But Western nations are vastly more wealthy and powerful exactly because we (largely) transact voluntarily.

So, even if extortion is not clearly delineated from externalities, we expect that businesses and business associations that do business in non-extortive ways to thrive and businesses and business associations that engage in extortive business practices to wither.

Here, it is likely far cheaper for the railroad to install a super spark emitter, or a flamethrower, than for the farmer to defend his fields from these sources.

But the railroad is impoverishing themselves by driving up the cost of food (and, hence, the cost of labor). Again, we only need to look to third world countries where this kind of protectionist or extortionist behavior is regularly tolerated. The net effect is that, compared to countries where this behavior is not tolerated (except by the government), they are vastly poorer as a result.

Indeed, since any prior allocation is possible, why stop with the farmer's fields? Another possible allocation would give the railroad a right to torch the farmer's barns, and his house, to kidnap his children -- any prior (ex ante) set of rules is supposed to be possible.

I think you're confusing the issue by failing to separate concerns. Let's say I have a business which, by virtue of its operation, has an X% chance of blowing up a random house in a certain region (and killing whoever's in it). Coase would say we can privatize the right to blow up houses or not have them blown up by either giving me the right to blow them up, or giving homeowners the right to not have them blown up, but the outcome will be the most efficient one either way (assuming zero transaction costs, yada yada). If I have the right to blow up houses, homeowners should be able to pay me not to blow up houses if they care enough to not have their houses blown up. If they can't afford to buy me off, perhaps they should be living somewhere else. Note that the right to inadvertently blow up someone's house in the course of doing whatever business I'm doing is easily distinguishable from taking a flamethrower or a bulldozer to their house, rights which I have not been given under this fictional scenario. Conversely, if homeowners have been given the right to not have their houses blown up, I can install safety devices or buy off homeowners to allow me the X% chance to blow up their houses, if what I'm doing is profitable enough. If it's not that profitable, perhaps I need to be doing something else.

In turn, if the ex ante rules allow, the farmer could threaten to tear up the railroad tracks or sabotage them to derail the trains.

I don't think Coase's theorem is saying that we should allow one party to do any tort to the other party. Rather, we are making the right to do or not do a specific action *owned*, so that people can then bargain and transact that (specific) right. It is not a generic license to tort.

if the ex ante rules so allow the railroad and farmer will bargain to avoid a negative-sum outcome: harm to the farmer with no direct benefit to the railroad, or vice versa.

Unfortunately, this situation does occur regularly in the real world and there appears to be no easy solution since in the countries where it occurs, there is no incentive for any individual party to solve the public goods problem of the general impoverishment which results. Instead, each individual reacts to the incentive to avoid a negative outcome (that is, engage in extortion to stay ahead) in the negative sum game. But all those countries have governments, and many of them have tort systems, which are also corrupt and part of the negative sum game.

Since there are substantial ex post benefits to one party from extorting payments from the other, the party that can threaten the most harm at the least cost to itself has, if the ex ante rules allow, a strong economic incentive to engage in such coercion. These negative-sum games of coercion and extortion lead to highly inefficient outcomes,

Which, as heartless as it may sound, is why this is a self-limiting problem. Somalia is a corrupt place, but they are also powerless and their legal system isn't exactly winning new converts throughout the world.

12:00 PM

Riemannzeta said...

First, I was only quibbling with the way you decided to put things. I agree with your point that the Coase Theorem is counterfactual

to any real world scenario (although in commodities markets, it may work pretty well as an approximation, as I hope eventually to show through some work on dynamic econometrics).

The biggest payload from the Coase Theorem has always been its negative implication, however. Even for Coase, what was interesting was not that the initial allocation of property rights didn't matter when transactions costs were zero. What was interesting and useful and surprising was that it was **transactions costs** that were preventing the fair allocation of resources as much as the initial allocation. In other words, Coase wasn't saying we shouldn't care about the initial allocation. He was merely pointing out that we needed to care about *both* the initial allocation and the transactions costs. In cases where we can do something about the former but not the latter, we should. In cases where we can do something about both, we should. But throw in Hayek's observation that markets are almost always better than experts at allocating things over the long-term, and you've got a pretty good prescription for a libertarian version of the state.

Coase may have nominally or casually "recognized" this problem, but neither Coase nor any other users of this Theorem as far as I am aware have seriously addressed this problem or tried to resolve it.

What you need to read is Richard Epstein's *Skepticism and Freedom*, wherein many of the same observations that you've made in your original post are fleshed out in a more systematic, comprehensive argument for a classical liberal form of government. Both the collectivist and anarchist forms of government are to be avoided for important but quite different reasons, and the Coase Theorem doesn't help us much in the end in sorting that out.

1:31 PM

nick said...

Clayton: *Every transaction is "coercive" by your definition. Is the seller coercing the buyer to give him $1.15 for the soda the buyer wants to purchase or is the buyer is coercing the seller to give away the soda he's selling for $1.15?*

Neither is coercion, and the distinction between this voluntary transaction and a coercive transaction is quite clear, as is the distinction between their economic consequences. A voluntary transaction like this one is generally a positive-sum transaction: both parties gain. If either party did not stand to gain from a voluntary transaction, it could simply decline the offer, with no harmful consequences. Extortion OTOH is a negative-sum game: if one party declines the transaction, harm to that party is inflicted, even at a cost to the inflictor, resulting in a net loss of wealth. There's a clear distinction between voluntary and coercive transactions, and between their expected consequences for economic efficiency -- positive in the case of voluntary transactions, and negative in the case of coercive transactions.

This clarity, however, breaks down in the case of negative externalities -- there is no strong and simple separation to be made between a harmful externality and coercion. Even if there was such a distinction, tort law or similar would be required, logically and temporally prior to Coaseian negotiation under contract law, to reify said distinction in order to render said transaction voluntary and thus positive-sum. In reality tort and criminal law have made a number of subtle and highly evolved distinctions (e.g. those between purposeful, knowing, negligent, and innocently accidental behavior) to tackle such problems.

BTW, government as we know it is *not* required for effective tort law, and I reject the false distinctions people people brought up on the false assumptions of modern political science usually make between government (usually implying a modern regulatory government) and anarchy. There are a wide variety of systems, for example systems of political property rights, that are neither anarchy nor anything resembling modern regulatory governments. So my proof that the Coase Theorem is false is in no way an argument in favor of modern government -- it is simply an argument against certain theoretical assumptions sometimes made in the law & economics movement and by anarcho-capitalism in particular.

11:06 AM

nick said...

reimannzeta: *What was interesting and useful and surprising was that it was transactions costs that were preventing the fair allocation of resources as much as the initial allocation.*

There are many problems with this sweeping conclusion that Coase and most of his followers have drawn from trying to reconcile the false Theorem with observable reality. Besides the logical problem that this conclusion is derived from a false premise, another huge problem is that it sweeps a very wide variety of costs under a rug labeled "transaction costs." It suggests an analogy between any of these costs and broker's fees (that's where the phrase "transaction cost" comes from), and that perhaps some innovation in bargaining like computerized trading is all that is required to lower any such cost. Nothing could be further from reality.

Coercion in particular is in no useful way analogous to a broker's fee. If the broker's fee is too expensive, the trader simply declines to trade. Extortion is a paradigmatically quite different kind of deal -- it changes the transaction from positive-sum to a negative-sum. There is no option for one party to decline a transaction that the party finds to be too expensive.

11:24 AM

Riemannzeta said...

I can't help but agree. It's an approximation, and anyone who leans to heavily on it without understanding its fictions is going to be misled.

But I still urge you to think about how productive and useful it was as a tool for persuading statists to permit a more prominent role for private ordering.

11:27 AM

nick said...

clayton: *let's consider region A where extortive bargaining is common and region B where mutually beneficial bargaining (voluntary transactions) is common. Over time, we expect region B to operate much more efficiently than region A.*

First of all, without good tort law region B won't exist, because there will be many opportunities for cheap coercion and thus high incentives for extortion. But if one fine day we have drastic divine intervention (perhaps the Simulators get bored) and region B miraculously springs into existence, its utopia will soon go extinct after immigration of mobsters or tax collectors from region A who set up profitable extortion rackets in region B. Nothing close to efficient outcomes happens unless there is good tort law, and probably some criminal law as well, preventing coercive bargaining.

11:41 AM

Riemannzeta said...

Here's a good teaser for the Epstein treatise:

http://books.google.com/books?id=B36vxZZ4cLcC&dq=richard+epstein+skepticism+and+freedom&pg=PP1&ots=Xz_k073h_5&sig=k8Q0ZenBAQHHSv83aIf6gy9fzok&hl=en&prev=http://www.google.com/search%3Fq%3DRichard%2BEpstein%2BSKepticism%2Band%2BFreedom%26ie%3Dutf-8%26oe%3Dutf-8%26rls%3Dorg.mozilla:en-US:official%26client%3Dfirefox-a&sa=X&oi=print&ct=title&cad=one-book-with-thumbnail#PPA110,M1

Search within the book for "Robert Lee Hale" and you'll find an interesting passage on Liberty and Coercion, which basically maps out much of the debate you're having with Coase here.

4:08 PM

Teh Internet said...

Perhaps, I didn't quite understand your argument but Friedman specifically treats the case when the railroad is permitted to throw off sparks as much as it wants.

http://www.daviddfriedman.com/laws_order/laws_order_chapter_5/laws_order_page_images/laws_order_page_47.htm
Farmers in this situation are supposed to buy spark arrester for the rail road at their own expense.

PS. I suppose, nothing prevents a sufficiently corrupt railroad from selling the arrester, pocketing the money and asking farmers for another one...

9:01 PM

Clayton said...

Link to a more readable version of Friedman's book:

http://www.daviddfriedman.com/Laws_Order_draft/laws_order_ToC.htm

Nick: In particular, look at Chapter 14, "Tort Law." Friedman is anarcho-capitalist, and I don't think he thinks the handling of torts can all be neatly wrapped up in Coase, though Coase's theorem helps us understand how at least some externalities can be handled without always going to court.

9:32 PM

nick said...

PS. I suppose, nothing prevents a sufficiently corrupt railroad from selling the arrester, pocketing the money and asking farmers for another one...

Exactly. Or the farmer from threatening to tear up the railroad tracks, should the law (or lack thereof) allow. Friedman completely ignores the most important set of cases, the negative-sum games (a.k.a. coercive bargains, a.k.a. extortion), the cases which prove the Coase Theorem false. Friedman is proceeding from a false premise, so there is no reason to expect he reaches true conclusions.

Clayton: the problem with Friedman's account of tort law is that he thinks tort law can be constructed from contracts between legal protection agencies, because as a Coase Theorist he sweeps the problem of coercive bargaining under the rug. As I have shown, tort law cannot originate from efficient bargaining, or anything close to it: coercive bargains are generally negative-sum games. Good tort and property law that greatly reduce opportunities for coercive bargaining are required before contract bargaining is anything close to efficient. Indeed one could not call it contract bargaining at all, it would be treaty bargaining between hostile powers. Stopping coercion is the most important problem, both for politics and law-and-economics, and the Coase Theorem is worse than useless for reasoning about it, because it is false in just those sets of cases.

I have read tons of Friedman and nothing whatsoever I have read leads me to believe that he has dealt in any reasonable way with this problem. If anybody has specific quotes of his you think refutes my proof, or any of my other claims, feel free to post them here.

12:19 PM

nick said...

PS. I suppose, nothing prevents a sufficiently corrupt railroad from selling the arrester, pocketing the money and asking farmers for another one...

Actually, now that I read this again, it brings up another way, besides coercion, in which anarcho-capitalist "contracts" are really treaties. When negotiating "contracts" without any overarching legal authority that can effectively enforce the contracts,

enforcement proceeds along the lines of treaty enforcement: might makes right, and treaties are broken quite often except against powers with sufficient military superiority, collective embargo clout (from coercing its citizens to respect the embargo), or similar to enforce them.

In the case of Coase himself and his non-anarchist followers, they assumed there was already a legal authority that effectively enforced contracts between the farmer and the railroad, so cheating like this by definition would not happen (and in reality would be no worse than for normal commercial contracts).

12:30 PM

Clayton said...

Clayton: the problem with Friedman's account of tort law is that he thinks tort law can be constructed from contracts between legal protection agencies, because as a Coase Theorist he sweeps the problem of coercive bargaining under the rug. As I have shown, tort law cannot originate from efficient bargaining, or anything close to it:

In the second article you cited, Friedman models the situation as a set of bilateral monopolies between every pair of protection agencies. Obviously, that's not efficient, market-like bargaining.

coercive bargains are generally negative-sum games. Good tort and property law that greatly reduce opportunities for coercive bargaining are required before contract bargaining is anything close to efficient. Indeed one could not call it contract bargaining at all, it would be treaty bargaining between hostile powers.

Friedman says as much (same article): "... the ultimate baseline is ... a bilateral monopoly bargaining game among the agencies. Each agency can threaten to refuse to agree to any arbitrator, **subjecting both to the costs of occasional violence**, or at least of ad hoc negotiation to avoid violence. Each knows that the other would prefer even a rather unfavorable set of legal rules to no agreement at all. Each knows that if no agreement is reached, they are both at risk of losing their customers to other agencies that have been more successful in negotiating agreements."

The real limitation to me seems to be the ability of "customers" (I assume he is meaning geographical populations of some sort) to peacefully cancel their contract with one protection agency and switch to another. In the real world today, this never seems to happen - Hezbollah's receipt of power in Gaza might be an example of this kind of a relatively non-violent change in suppliers of security services.

Stopping coercion is the most important problem, both for politics and law-and-economics, and the Coase Theorem is worse than useless for reasoning about it, because it is false in just those sets of cases.

I really can't comment directly to that except to say that I think you may be overstating the case in saying that Friedman is resting his hat entirely on Coase's theorem. On my reading of his article (the second article you cited), he seems to be appealing to a broad array of economic ideas.

3:58 PM

Teh Internet said...

On a second thought, the amount of money the railroad will be able to extort from the farmers is bounded from above by the cost of switching to non-flammable crops (clover in Friedman's example).
Ask for more and farmers would just grow clover and to hell with the railroad and its sparks.

So the rational outcome seems to be:
* railroad gets an spark arrester plus bonus (equal to efficiency gain).
* farmers grow wheat.

This is unfair, but it still economically efficient. The problems seem to appear when this situation turns into a rent seeking tug-o-war. I don't think contract law can fully eliminate this issue.

7:15 PM

nick said...

Clayton, Friedman is still assuming that all the contracts, except the "occasional violence" which he proceeds to ignore, are the positive-sum voluntary contracts assumed by other economists when they use the Coase Theorem or the theory of bilateral monopoly. The disproof that the bilateral theory monopoly applies here is similar to that for the Coase theorem: bilateral monoply theory assumes voluntary transactions yet purports (as Friedman applies it) to work in a world where opportunities and incentives for coercive transactions are ubiquitous. The assumptions are contradictory and prove the application of bilateral monopoly theory in this situation (and analogous analyses of politics or law) to be false.

You and Friedman both need to go back and read my original article above. The negative-sum game is basic to the problem: it is not a mere "transaction cost" or "occasional violence" that can be swept under the rug in order to invoke the convenient authority of economic theories that assume voluntary transactions. Now that I have pointed out the problem in a very clear fashion, one has to be a complete logical illiterate to believe that one can invoke economic theories that assume voluntary transactions to prove that coercion is not a problem.

Each knows that the other would prefer even a rather unfavorable set of legal rules to no agreement at all.

Nice try to get out of a jam, but it is extremely far off the mark. Both parties would prefer to extort the maximum possible from the other party at the least cost to themselves. That is the negative-sum game that is basic to situations not already governed by at least tort law. You and Friedman are jumping through some amazing hoops to avoid confronting this problem.

"teh internet": *the amount of money the railroad will be able to extort from the farmers is bounded from above by the cost of switching to non-flammable crops (clover in Friedman's example).*

This is of course nonsense. If one method of coercion becomes too expensive, there are usually many alternatives available. In this case, the railroad could switch to spraying the field with herbicide. Or it could wait until the field is harvested into hay and send in an arsonist to set fire to the hay. Under the Coaseian assumption that any prior allocation of legal rights is possible, the legality of any of these acts are possible prior allocations of legal rights. The fact of the matter is that when Coase, Stigler, et. al. worked out these examples they were already assuming the beneficial effects of tort and property law as well as rights allocations within these laws that ruled out such coercive acts: a hidden assumption that contradicts the overt claim, necessary to Friedman's reasoning, that they they proved the Coase Theorem for *any* prior legal allocations. Since externalities are often not readily separated from coercion, the Coase Theorem is false: it does not apply in a world where coercion is possible. There is no easy way to apply it to negative externalities which usually come bundled with opportunities to make coercive threats. When dealing with externalities problems, one must confront *both* coercion and transaction cost problems. Lowering bargaining and enforcement costs may well cause *more* harm when the bargaining is over a negative-sum game.

11:42 AM

Teh Internet said...

If one method of coercion becomes too expensive, there are usually many alternatives available. In this case, the railroad could switch to spraying the field with herbicide. Or it could wait until the field is harvested into hay and send in an arsonist to set fire to the hay.

The railroad might do it once - as a threat, but I don't think they would keep on destroying farmer's property. That'd just eat into extortion profits.
Instead the railroad thugs should just make an offer, the farmers cannot refuse: "give us all your money and we'll will make sure nothing happens to your crops" I think this is how actual racketeers operate.

Moreover, if the railroad is interested in long-term profits, then they should even leave some money to farmers for reinvesting, perhaps under strict supervision. The situation looks to me more and more like an ordinary firm or government.

PS. I am not arguing Friedman's viewpoint, I am mostly using him as a reference example because I have read his book recently. My own impression so far is that you always can get to an efficient outcome - but the time required to get there might be longer than the characteristic time of the system.

1:16 PM

George Weinberg said...

Nick, have you tried to get Friedman to respond to the the ideas in this post? He has a blog so I think he's reasonably willing to discuss his ideas over the internet.

It seems fairly obvious to me that before two parties can even think about making a contract they have to have at least enough common understanding that the contract will mean more or less the same thing to both parties, and for the contract to have any teeth there must be third parties which will also interpret the contract in more or less the same way and will react negatively towards contract breakers. But this argument seems to go well beyond that.

I'm not convinced that the Coase theorem is completely worthless, but at least it would seem to require some clarification.

3:19 PM

Clayton said...

The negative-sum game is basic to the problem: it is not a mere "transaction cost" or "occasional violence" that can be swept under the rug in order to invoke the convenient authority of economic theories that assume voluntary transactions.

Then why is global wealth increasing, instead of decreasing? If the absence of tort law entails a negative sum game (essentially, this is the argument you are making), then we would expect global wealth to decrease over time, not increase.

Sovereign states are anarchic in the sense that there's no police or court that can throw the President of Khazakstan in jail for breaking a treaty with his neighbor. Yet, somehow, sovereign states are only in a state of active hostilities a tiny minority of the time.

4:51 PM

Clayton said...

Conclusion to my last comment (published too quickly):

My conclusion is that the global anarchy of sovereign states (relative to one another sovereign states are largely in a state of anarchy) apparently constitute a positive-sum game. Therefore, the data indicate that it is false that the absence of tort law entails a negative-sum game.

4:54 PM

nick said...

George, David is free to to come over here and debate me, or to invite me to debate at any other reasonable forum. Any readers who can't be convinced by a straightforward proof are free to contact him to try to get him to try to find a flaw in it. He won't be able to do so, so I doubt he'll respond, but you can try.

Clayton: *My conclusion is that the global anarchy of sovereign states (relative to one another sovereign states are largely in a state of anarchy) apparently constitute a positive-sum game. Therefore, the data indicate that it is false that the absence of tort law entails a negative-sum game.*

First, it's a funny argument to try to defend anarcho-capitalism by invoking a positive outcome produced by governments. That one set of coercions(modern governments) usually lead to at least somewhat positive-sum overall outcomes on average doesn't at all demonstrate that very different kinds of coercions (e.g. legal protection agencies) will do so, much less that they will be even better.

Second, you're confusing the singular and the plural, the local game with the overall outcome. I claimed that interactions between legal protection agencies (and of course governments in the international sphere) involve negative sum *games*, plural. For example wars, embargoes, etc. or threats of same. I didn't claim that they don't also involve some positive-sum games, nor did I claim that the overall outcome under and between governments is negative-sum.

Negative-sum games like war are impossible under the Coase Theorem. The Coase Theorem is worse than useless for explaining international outcomes and Friedman's use of the Coase theorem to try to predict the outcome between legal protection agencies is similarly quite fallacious.

Never have I made the obviously fallacious claim you impute to me, that the overall outcome of a world that includes many negative-sum games is necessarily negative sum. There may be a number of good explanations for why a world with governments and international relations is usually positive-sum -- I suggest reading Mancur Olson for example -- but the Coase Theorem, which assumes that negative-sum games like extortion, taxation, and war don't even exist, is not anywhere close to being one of these reasonable explanations.

These governments generally have tort law or similar internally that creates a positive-sum environment. These positive-sum economic games made possible by tort law usually more than offset the many negative-sum games that governments play externally. It may also be the case that the dynamic of mixed negative- and positive-sum games in international relations by themselves usually leads to a mildly positive-sum outcome. None of this has anything to do with the Coase Theorem: once negative-sum games can happen the Coase theorem is false.

11:00 AM

nick said...

While I'm here, I (inspired by a real legal case I learned from a friend, who shall remain nameless unless he wants to be credited) came up with the following example that lays the problem with the Coase Theorem out in clear mathematical terms even in a fairly normal case of externalities (i.e. nothing "extreme" like flamethrowers or clover-killing herbicide or mob hits):

A music store is next door to a doctor's office. The music store would prefer (if the office of a rich doctor who wants quiet for his patients did not exist next door) to let its customers test its electric guitars at volume VM1 > 0. The doctor prefers it to be quieter (VD < VM1). Coase theory assumes that the only possible choices are within the range {VM1, VD}, i.e. any volume of electric guitar testing in between or including these two preferences. In the absence of transaction costs and given only this range, one can indeed conclude that the music store and the doctor will bargain to an efficient outcome. But these aren't the only choices. The music store can, at additional cost to itself C, turn up the volume nobs on its amplifiers and play the music at volume VM2 > VM1. If the doctor is willing to pay the music store P1 to change the volume from VM1 to VD, and P2 > P1 + C to turn the volume down from VM2 to VD, the music store has an incentive to play the music at volume VM2 instead of VM1, or to threaten same, in order to extract for itself a greater benefit from the situation.

In other words, the same physical effect that produced the externality gives rise to an opportunity and incentive to play a negative-sum game. Here it changes the music store's prefered volume in the absence of a rich doctor next door from VM1, to VM2 > VM1, due to the opportunity to extort extra payments from the doctor by creating an even less bearable din, for which the doctor is willing to pay even more to avoid. The music store is willing to incur an extra cost C to itself in order to extract the greater payment P2 from the doctor. For the overall game the payment P2 is a wash and C makes it negative-sum. (In the music store example, cost C comes

from the music store chasing away some of its own customers, albeit at a slower rate than it chases away the doctor's customers, by testing its guitars more noisly than it would prefer in the absence of the doctor).

If, as in reality, there are transaction costs causing bargains to sometimes not be reached, the outcome is even worse, as noise VM2 is costlier, perhaps far more costlier, to the doctor's practice than VM1: such outcomes are often far worse outcome under transaction costs than the range of possible outcomes that Coaseians contemplate.

Of course, more generally in the absence of proper prior legal allocations of rights the doctor and music store could threaten each other in other ways: the doctor could threaten to poison the guitar frets, the music store could call in the mob on the doctor, etc. (Furthermore, even with tort law preventing these other negative-sum games the music store has an incentive to falsely "reveal" preference VM2 instead of VM1 to the doctor and to the judge -- a common problem that good tort law usually, but hardly with perfection, tackles). But the example of the music store and its amplifier volume shows that the externality itself contains potential or actual coercion -- the same physical effect that causes the externality often makes negative-sum games possible, and in the absence of any prior legal limits on the externality, opportunities and incentives for coercive negative-sum games are inherent in the externality -- so that analyses of such externalities with the Coase Theorem, which assumes such games don't exist, will often lead to misleading or false conclusions.

12:01 PM

peco said...

Once the money is paid (immediately because of zero transaction costs?), the store will lower the volume, so it would be a zero-sum game (the doctor loses some, the store gains the same amount). The doctor wouldn't be harmed by the music because he can pay the money in zero time.

(I'm not sure if zero transaction costs means that the doctor can do everything instantly, though.)

7:07 PM

nick said...

peco,the game is negative-sum for the same reason a tax is, firstly because the music store's coercion distorts the behavior of the doctor and his patients. Assuming the doctor is helpless to stop the noise without making the payoff (e.g. we artificially assume he can't order a mob hit on the music store, or poison its customers, or emit any other such "extreme" externality to avenge or deter the music store's excess externality) he will go golfing more, and see fewer patients, if he is paying P2 to the store instead of P1. Fewer patients will be healed, a net loss of welfare. Since we assume the music store is rational, it will demand only the Laffer-maximum amount of extortion, but Laffer-maximum taxes still have plenty of distoritve effects that produce inefficiencies compared to the no-taxation case. Secondly, the behavior of the music store is also distorted because it has excess profits to spend. It will invest its extra money in opening new music stores and concert halls next to other doctor's offices, nursing homes, and similar because that is a lucrative source of profit, and so other activities that would prefer quiet will be distorted in turn. It is often unreasonable to assume that Coaseian payees are spending their extra money efficiently. Interestingly, shades of Clayton's reasoning, Gary Becker assumed the Coaseian payor's behavior was not distorted and that the Coaseian payee was spending its extra profits efficiently, and used this Coaseian reasoning to argue that governments themselves are efficient outcomes of Coaseian bargaining. Becker's argument is wrong for the same reason that Friedman's argument is wrong for legal protection agencies: it doesn't account for the economic distortions caused by coercion.

To see where these negative-sum games lead, let's take the case of roving loudspeakers. Pickup trucks drive through the city, parking in front of every business in turn and demanding large payments to take their noise elsehwere. The optimal extortion for the extortors in this case is nearly 100% of all business wealth in the city (again assuming the victims are defenseless), because if extortor A doesn't extort any remaining wealth extortor B will be happy to come in and take it. The economy is so distorted that practically nothing gets produced or distributed and the city's economy collapses. This is the "roving bandit" case studied by Mancur Olson. Where two stores are next to each other and neither can move constitute "stationary bandits", as do gangs or governments with "monopolies of coercion" over fixed territories. As the roving loudspeakers case illustrates, rational stationary bandits collect a far

lower percent of their victims' profits in taxes than do roving bandits. (But stationary bandits with the much lower rate than 100% end up collecting a far higher absolute amount -- recall the Laffer curve) . If on the other hand we assume the victims are *not* defenseless, we have negative-sum games like hawk/dove, negative tit-for-tat, etc. which again are paradigmatically very different from voluntary Coaseian bargains.

We can measure the effectiveness of an excess (or coercive) externality for extracting super-Coasiean payoffs by how great a harm the externality can produce for the least cost to the emitter. The ubiquity of technology that is very effective in producing the greatest harm for the least cost, i.e. weapons, in our world should be a very good clue that our world is not Coaseian. Music volume, spark emission, and so on beyond the "preferered" level Coaseians falsely assume to be maximal are logically weapons. Their harm/cost ratio is lower than guns, tanks, bombers, missiles, flamethrowers, herbicides, and so on, but they have an advantage in being physically hard to distinguish from merely Coaseian externalities, which would come in handy in a world where judges and other lawmakers actually based law on the Coase theorem (the good news is that they mostly don't).

I should note that the basic argument that the Coase Theorem is inapplicable for political analysis, because it assumes voluntary bargaining and politics is coercive, comes from Olson. My contributions above are (1) a rigorous disproof of the claim that the Coase theorem is generally applicable to externalities, because its assumption are contradictory in both allowing and excluding coercion, (2) to show the continuum from externalities to coercion, that the two are not readily separable.

1:34 PM

peco said...

Aren't we only talking about the doctor and the music store (as if they are the only ones who exist)? If there other doctors, the doctors could pay relatively little to get the government to stop the music stores. The government doesn't want the economy messed up (because that would decrease the taxes it could collect), and, again, it would act instantly before any actual harm was done by the music.

1:53 PM

nick said...

pecos: *If there other doctors, the doctors could pay relatively little to get the government to stop the music stores.*

"The government stopping the music stores" violates the claim of the Coase Theorem, that it is supposed to work under any prior allocation of legal rights. Your observation reinforces the fact that the Coase Theorem is false.

12:05 PM

peco said...

"The government stopping the music stores" violates the claim of the Coase Theorem, that it is supposed to work under any prior allocation of legal rights. Your observation reinforces the fact that the Coase Theorem is false.

If the government has the ability (right) to stop the music store in this case, someone will still have it in any other arrangement of the property (since all the property still exists). The doctors can just go to that person (or arrange more transactions if the person has the right to do it but not the means).

I'm not sure if this would work, but if the doctor calculated the optimal way to distribute the property (since he is rational, he should know it--should he?) and convinced everyone to accept it (they might, because they are also rational and the distribution is optimal, and nobody is harmed), he could solve any problem. I'm not sure people who would be better off with a non-optimal distribution would accept it, though.

3:33 PM

Tenius said...

Well, I disagree. Not that I am that fond of Coase theorem, or think that it is, oh so terribly useful. Not at all, but...

Can I start with an analogy? Thanks.

Nick, will it not be a lot easier to convince people of right principles if you have the option of killing those who disagree? You know critical rational argumentation takes a lot of time and and toil and the result is never certain. And just the threat of annihilation can do wonders... ;)

Well that said, my point is: The Coase theorem is correct if, for whatever reasons, violence and coercion are not an option. It can be, as you have pointed out, whatever legal framework that exists, or it can be.. nukes on both sides.

So, no Coase's theorem does not depends (specifically) on tort law, it depends on violence being not on option. Or being a very costly one.

1:52 AM

Douglas Knight said...

The comparison between negative externalities and coercion is nice, but it does no *formal* damage to the theorem. It just predicts that the extorter will take all the money, or at least up to some threshold at which the victim values the threat. What "no transaction costs" means in the setting of extortion is that both parties are transparent: the threat is credible and the amount that can be demanded is clear. The negative sum game isn't actually played.

6:04 PM

nick said...

In response to Douglas Knight: the term "transaction costs" was coined by analogy to a broker's fee: it is a cost one can decline to pay by declining to enter into the transaction, with no direct negative costs (only possible opportunity costs). OTOH coercion can be "an offer you can't refuse", or more generally has negative utility on the coerced whether he declines it or not. Coercion is a phase change, not a mere additive cost, and it is highly confusing and misleading at best (I think it is just plain wrong) to bury it under the rubric of "transaction costs", as if it was usefully analogous to a broker's fee, and then proceed (as many users of the Coase theorem do) to forget about its importance.

Of course, if you define "transaction cost" as "any problem at all that might arise that would render the Coase Theorem false", then the Coase theorem is tautologically true: it is completely trivial and meaningless.

4:03 PM

nick said...

Douglas, without a credible threat, whether to increase the sparks or simply install a flamethrower, the extorter cannot profitably extort. This investment in weaponry, whether the subtle weaponry of a negative externality or overt weaponry, makes extortion a negative-sum game. The only way the extortion could not be (in this already extremely abstract and imaginary world) negative sum is if the extorter has a perfect weapon that cost him nothing, the victim is absolutely defenseless, and the victim's output function is completely inelastic, so that the victim works for the extorter just as hard as if the victim rather than the extorter were earning the bulk of the surplus. Any of these three assumptions are heady flights of the imagination.

But then again, in the imaginary world of a Coase theorist even such important phenomena as threats, security costs, arms races, and Laffer curves are mere "transaction costs" that like many other crucially important matters can be swept under that all-covering rug.

4:19 PM

peco said...

Nick,

How does the extorter get his weapons? He is probably paying someone, and nobody is directly harmed by that transaction.

Coercion is a phase change, not a mere additive cost, and it is highly confusing and misleading at best (I think it is just plain wrong) to bury it under the rubric of "transaction costs", as if it was usefully analogous to a broker's fee, and then proceed (as many users of the Coase theorem do) to forget about its importance.

Using a weapon would *not* be any sort of transaction, so the bad effects are not an externality or a transaction cost.

Suppose you have a slave owner, a cotton buyer, and a bunch of slaves (and they are the only people in the universe). The cotton buyer has a lot of food, which he exchanges with the slave owner for cotton, which is converted by his magic wand to food. The cotton buyer also has a weapon. The slave owner has computer games (lol), and the slaves don't have anything. Is there another person you could give the weapon to who could use it less? (Assuming everyone is completely defenseless.) No, because the person with the weapon will always use it on everyone else to get stuff. This *is* an efficient outcome (after the food is traded with the computer games) because you can't make the slaves and the cotton buyer better off without getting rid of the weapon (which would harm the slave owner).

11:35 AM

peco said...

Also, rational people with weapons won't use them because they can just threaten to use them and still get the same result.

11:40 AM

Post a Comment

Newer Post Home Older Post

Subscribe to: Post Comments (Atom)

Simple theme. Powered by Blogger.